

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE COMPLIANCE)
STRATEGIES OF ELECTRIC UTILITIES RELATED) ADMINISTRATIVE
TO THE CLEAN AIR ACT AMENDMENTS OF 1990) CASE NO. 339

O R D E R

The Commission initiated this case on August 15, 1991, to gather information and allow the affected electric utilities to comment on provisions of the Clean Air Act Amendments of 1990 ("CAAA") which have an impact on rates or service within our jurisdiction. Big Rivers Electric Corporation, East Kentucky Power Cooperative, Inc. Kentucky Power Company, Kentucky Utilities Company, and Louisville Gas and Electric Company ("LG&E"), each of which own generating facilities, were made a party to this proceeding.

Kentucky Industrial Utility Customers, the United Mine Workers of America, the Jefferson County Attorney, the Attorney General of the Commonwealth of Kentucky and the Kentucky Alliance for Fair Utility Competition intervened. Orders have required comments and filing the compliance plans of the generating utilities and their CAAA permit applications to the United States Environmental Protection Agency ("EPA").

The utilities suggested that the Commission should provide a free and open market for emission allowance trading, allow expeditious recovery of compliance costs, and evaluate compliance

options in light of conditions as they exist at the time the decisions are made.

LG&E also suggested that the Commission establish a process to pre-approve CAAA compliance plans and issue guidance on the accounting and regulatory treatment of costs and revenues of allowance trading.

Concerning these issues, the recently enacted environmental surcharge statute, KRS 278.183, authorizes utilities to submit their CAAA compliance strategies for Commission approval and recover reasonable compliance costs through an environmental surcharge. Each affected utility will likely create its own strategy for allowance trades based on its unique compliance plan. These plans may differ greatly among themselves and not every utility will be required by the EPA to prepare one. Such a complex, multifaceted factual issue as allowance trading cannot properly be addressed in a generic proceeding. Thus, specific guidance on these issues can be provided only on a case-by-case basis.

However, some general observations can be made at this time. LG&E suggested that the Commission should address the accounting and regulatory treatment of such activities as transfers of allowances in return for project ownership, discounted future power purchases, over-compliance in order to generate additional excess allowances, and the operation of a revenue incentive mechanism.

The Commission encourages utilities to take advantage of allowance trading that is economically justified. Utilities able

to obtain extension and bonus allowances should be prepared to explain why they did or did not take advantage of these opportunities.

The Commission will consider all reasonable contractual relationships, including pooling arrangements, that facilitate trading emission allowances. In establishing their optimal CAAA compliance strategies, utilities should consider contractual arrangements among Kentucky jurisdictional, as well as out-of-state utilities. Arrangements with fuel suppliers, brokers, environmental groups, and others will be reviewed on a case-by-case basis to determine their cost effectiveness in achieving compliance or generating additional income or allowances for the utility. If any activity is found unreasonable, the associated cost would be excluded.

The appropriate rate-making treatment for emission allowance trading or use will be determined on a case-by-case basis. A utility's actions in the allowance trading markets will be examined using the same standard of reasonableness used for any utility transaction.

Each jurisdictional utility shall submit basic information and a status report on its allowance trading activities with its annual FERC Form No. 1 filing. This filing shall include a description of the utility's plans and procedures for monitoring and, if appropriate, participating in the emission allowance markets. The report shall include complete details of the utility's allowance

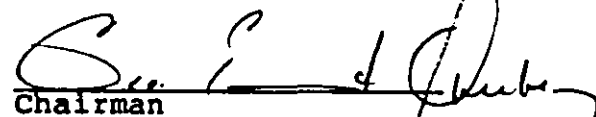
trading activity for the year and explain the basis for deciding to bank allowances.

The three private electric utilities currently utilize the accounting requirements prescribed by the Federal Energy Regulatory Commission ("FERC") for general accounting and reporting purposes. The two Rural Electrification Administration ("REA") funded Generation and Transmission cooperatives utilize the REA's Uniform System of Accounts. The FERC has adopted new accounting requirements for accounting for Clean Air Act Emissions Allowances. All shall follow Title 18, CFR, Part 101 as amended by FERC effective January 1, 1993, to account for allowance transactions.

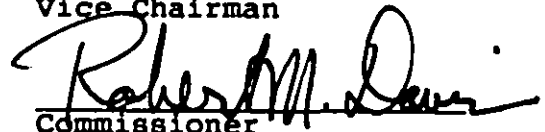
IT IS THEREFORE ORDERED that this case shall remain open to enable the Commission to monitor development of rules and regulations by the EPA and other federal agencies, and to obtain additional information as needed.

Done at Frankfort, Kentucky, this 18th day of August, 1993.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director